London Borough of Harrow Pension Fund
Funding Strategy Statement
As at 29 February 2012

1. Introduction

This is the Funding Strategy Statement (FSS) of the London Borough of Harrow Pension Fund ("the Fund"), which is administered by Harrow Council, London ("the Administering Authority").

It has been reviewed by the Administering Authority in collaboration with the Fund's Actuary, Hymans Robertson, after consultation with the Fund's employers and investment adviser. This revised version replaces the previous FSS and is effective from 29 February 2012.

1.1 Regulatory Framework

Scheme members' accrued benefits are guaranteed by statute. Members' contributions are fixed in the Regulations at a level that covers only part of the cost of accruing benefits. Employers currently pay the balance of the cost of delivering the benefits to members. The FSS focuses on the pace at which these liabilities are funded and, insofar as is practical, the measures to ensure that employers or pools of employers pay for their own liabilities.

The FSS forms part of a framework, which includes:

- The Local Government Pension Scheme Regulations[1] (Regulations 34, 35 and 36 of the Administration Regulations are particularly relevant);
- the Rates and Adjustments Certificate, which can be found appended to the Fund Actuary's triennial valuation report;
- actuarial factors for valuing early retirement costs and the cost of buying extra service; and
- the Statement of Investment Principles (SIP).

Operating within this framework, the Fund's Actuary carries out triennial valuations to set employers' contributions and provides recommendations to the Administering Authority when other funding decisions are required, for example when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

1.2 Reviews of FSS

The FSS is reviewed in detail at least every three years, ahead of triennial valuations being carried out; the next full review will fall due to be completed by 31 March 2014. Annex A is updated more frequently to reflect any changes to employers.

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[1] **Consisting of The Local Government Pension Scheme (Administration) Regulations 2008, The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 ("the Benefits Regulations"), The Local Government Pension Scheme (Administration) Regulations 2007 ("the Administration Regulations") and The Local Government Pension Scheme (Transitional Pensions) Regulations 2007 ("the Transitional Regulations").**

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The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues. If you have any queries please contact Julie Alderson in the first instance at julie.alderson@harrow.gov.uk or on tel: 020-8424-1788.

2. Purpose

2.1 Purpose of the FSS

The purpose of the FSS is:

- "to establish a clear and transparent fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- to support the regulatory framework to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities."

These objectives are desirable individually, but may be mutually conflicting.

This statement sets out how the Administering Authority has balanced the conflicting aims of affordability of contributions, transparency of processes, stability of employers' contributions, and prudence in the funding basis.

2.2 Purpose of the Fund

The Fund is a vehicle by which scheme benefits are delivered. The Fund:

- receives contributions, transfer payments and investment income;
- pays scheme benefits, transfer values and administration costs.

One of the objectives of a funded scheme is to reduce the variability of pension costs over time for employers compared with an unfunded (pay-as-you-go) alternative.

The roles and responsibilities of the key parties involved in the management of the pension scheme are summarised in Annex B.

2.3 Aims of the Funding Policy

The objectives of the Fund's funding policy include the following:

- to ensure the long-term solvency of the Fund as a whole and the solvency of each of the notional sub-funds allocated to the individual employers or pool of employers;

- to ensure that sufficient funds are available to meet all benefits as they fall due for payment;

- not to restrain unnecessarily the investment strategy of the Fund so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;

- to help employers recognise and manage pension liabilities as they accrue;

- to minimise the degree of short-term change in the level of employer's contributions where the Administering Authority considers it reasonable to do so.

3. Solvency Issues and Target Funding Levels

3.1 Derivation of Employer Contributions

Employer contributions are normally made up of two elements:

a) the estimated cost of future benefits being accrued, referred to as the "*future service rate*"; plus

b) an adjustment for the funding position (or "solvency") of accrued benefits relative to the Fund's solvency target, "*past service adjustment*". If there is a surplus there may be a contribution reduction, if a deficit a contribution addition, with the surplus or deficit spread over an appropriate period.

The Fund's Actuary is required by the regulations to report the *Common Contribution Rate*[2], for all employers collectively at each triennial valuation. It combines items (a) and (b) and is expressed as a percentage of pay. For the purpose of calculating the Common Contribution Rate, the surplus or deficit under (b) is currently spread over a period of 20 years.

The Fund's Actuary is also required to adjust the Common Contribution Rate for circumstances that are deemed "peculiar" to an individual employer[3]. It is the adjusted contribution rate which employers are actually required to pay. The sorts of peculiar factors which are considered are discussed in Section 3.5.

In effect, the *Common Contribution Rate* is a notional quantity. Separate future service rates are calculated for each employer or pool together with individual past service adjustments according to employer (or pool) -specific spreading and phasing periods.

[2] See Regulation 36 (5) of the Benefits Regulations
[3] See Regulation 36 (7) of the Benefits Regulations

For some employers it may be agreed to pool contributions, see Section 3.7.8.

Annex A contains a breakdown of each employer's contributions following the 2010 valuation for the financial years 2011/12, 2012/13 and 2013/14. It also identifies which employers' contributions have been pooled with others.

Any costs of early retirements other than on the grounds of ill-health must be paid as lump sum payments at the time of the employer's decision in addition to the contributions described above (or by instalments shortly after the decision where requested by the Administering Authority).

Employers' contributions are expressed as minima, with employers able to pay regular contributions at a higher rate. Employers should discuss with the Administering Authority before making one-off capital payments.

3.2 Solvency and Target Funding Levels

The Fund's Actuary is required to report on the "solvency" of the whole fund at least every three years.

'Solvency" for ongoing employers is defined to be the ratio of the market value of assets to the value placed on accrued benefits on the Fund Actuary's *ongoing funding basis*. This quantity is known as a funding level.

The ongoing funding basis is that used for each triennial valuation and the Fund Actuary agrees the financial and demographic assumptions to be used for each such valuation with the Administering Authority.

The Fund operates the same target funding level for all ongoing employers of 100% of its accrued liabilities valued on the ongoing basis. Please refer to paragraph 3.8 for the treatment of departing employers.

Where an admission agreement for an admission body, that is not a Transferee Admission Body and with no guarantor, is likely to terminate within the next 5 to 10 years or lose its last active member within that timeframe, the fund reserves the right to set contribution rates by reference to liabilities valued on a gilts basis (i.e. using a discount rate that has no allowance for potential investment outperformance relative to gilts). The target in setting contributions for any employer in these circumstances is to achieve full funding on a gilts basis by the time the agreement terminates or the last active member leaves in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required when a cessation valuation is carried out.

The Fund also reserves the right to adopt the above approach in respect of those admission bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease.

3.3 Ongoing Funding Basis

(a) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds advised by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of "VitaCurves", produced by the CLUBVITA's detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with "medium cohort" and a 1% pa minimum underpin to future reductions in mortality rates.

The combined effect of the above changes from the 2007 valuation approach, is to add around one year of life expectancy on average. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members' benefits.

(b) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund's investments. The investment return assumption makes allowance for an anticipated out-performance of returns from equities relative to Government bonds. There is, however, no guarantee that equities will out-perform bonds. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective returns from equities is taken.

For the purpose of the triennial funding valuation at 31 March 2010 and setting contribution rates effective from 1 April 2011, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.6% per annum greater than the return available from investing in government bonds at the time of the valuation (this is the same as that used at the 2007 valuation). The long term in this context would be 20 to 30 years or more. In the opinion of the Fund actuary, based on the current investment strategy of the Fund, an asset out-performance assumption (AOA) of 1.6% per annum is within a range that would be considered acceptable for the purposes of the funding valuation.

(c) Salary growth

Pay for public sector employees will be frozen by Government until 2012, with a flat increase of £250 being applied to all those earning less than £21,000 pa. Although this “pay freeze” does not officially apply to local government employers, it has been suggested that they are expected to show similar restraint in respect of pay awards. Based on an analysis of the membership in LGPS funds, the average expected increase in pensionable pay across all employees should be around 1% pa for the next couple of years. Therefore the salary increase assumption at the 2010 valuation has been set to 1% pa for 2010/11, 2011/12 and 2012/13 in the expectation that pay growth will be limited until March 2013. After this point, the assumption will revert back to RPI plus 1.0% p.a. This is lower than the assumption adopted at the 2007 valuation of RPI plus 1.5% p.a.

(d) Pension increases

The Chancellor of the Exchequer announced in his Emergency Budget on 22 June 2010 that the consumer prices index (CPI) rather than the retail prices index (RPI) will be the basis for future increases to public sector pensions in deferment and in payment. This proposed change has been allowed for in the valuation calculations as at 31 March 2010.

At the previous valuation, we derived our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. For the 2010 valuation, this market-derived rate has been adjusted downwards by 0.5% pa to allow for the “formula effect” of the difference between RPI and CPI. Basing pension increases on CPI rather than RPI will serve to reduce the value placed on the Fund’s liabilities.

(e) General

The same financial assumptions are adopted for all employers for whom the ongoing basis is deemed to be appropriate. All employers have the same asset allocation as described in Section 3.6.

The demographic assumptions vary by type of member and so reflect the different membership profiles of employers.

3.4 Future Service Contribution Rates

The future service element of the employer contribution rate is calculated on the ongoing valuation basis, with the aim of ensuring that there are sufficient assets built up to meet future benefit payments in respect of future service. For the 2010 valuation, the future service rate has been calculated separately for all the employers although employers within a pool will pay the contribution rate applicable to the pool as a whole.

Where it is considered appropriate to do so, the Administering Authority reserves the right to set a future service rate by reference to liabilities valued on a lower discount rate (most usually for Admission Bodies in the circumstances outlined in 3.2).

The approach used to calculate the employer's future service contribution rate depends on whether or not new entrants are being admitted in line with the approach described below. Employers should note that it is only Admission Bodies that may have the power not to admit automatically all eligible new staff to the Fund, depending on the terms of their Admission Agreements and employment contracts.

3.4.1 Employers that admit new entrants

The employer's future service rate will be based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year. Technically these rates will be derived using the *Projected Unit Method* of valuation with a one-year control period.

If future experience is in line with assumptions, and the employer's membership profile remains stable, this rate should be broadly stable over time. If the membership of employees matures (e.g. because of lower recruitment) the rate would rise.

3.4.2 Employers that do not admit new entrants

Where Admission Bodies have closed the scheme to new entrants, this is expected to lead to the average age of employee members increasing over time and hence, all other things being equal, the future service rate is expected to increase as the membership ages.

To give more long-term stability to such employers' contributions, the *Attained Age* funding method is normally adopted. This will limit the degree of future contribution rises by paying higher rates at the outset.

Both funding methods are described in the Actuary's report on the valuation.

Both future service rates include an allowance for expenses of administration to the extent that they are borne by the Fund and include an allowance for benefits payable on death in service and ill health retirement.

3.5 Adjustments for Individual Employers

Adjustments to individual employer contribution rates are applied both through the calculation of employer-specific future service contribution rates and the calculation of the employer's funding position.

The combined effect of these adjustments for individual employers applied by the Fund Actuary relate to:

- past contributions relative to the cost of accruals of benefits;
- different liability profiles of employers (e.g. mix of members by age, gender, part-time/full-time, manual/non manual);
- the effect of any differences in the valuation basis on the value placed on the employer's liabilities;
- any different deficit/surplus spreading periods or phasing of contribution changes;
- the difference between actual and assumed rises in pensionable pay;
- the difference between actual and assumed increases to pensions in payment and deferred pensions;
- the difference between actual and assumed retirements on grounds of ill-health from active status;
- the difference between actual and assumed amounts of pension ceasing on death;
- the additional costs of any non ill-health retirements relative to any extra payments made;

over the period between each triennial valuation period.

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers, unless the circumstances dictate otherwise.

The Fund Actuary does not allow for certain relatively minor events occurring in the period since the last formal valuation including, but not limited to:

- the actual timing of employer contributions within any financial year;
- the effect of the premature payment of any deferred pensions on grounds of incapacity.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

3.6 Asset Share Calculations for Individual Employers

The Administering Authority does not account for each employer's assets separately. The Fund's Actuary apportions the assets of the whole Fund between the employers (or pools of employers) at each triennial valuation using the income and expenditure figures provided for certain cash flows for each employer (or pool of employers). This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus". The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund. The asset apportionment is capable of verification but not to audit standard.

The Administering Authority recognises the limitations in the process, but having regard to the extra administration cost of building in new protections, it considers that the Fund Actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

3.7 Stability of Employer Contributions

3.7.1 Solvency Issues and Target Funding Levels

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, there are a number of prudential strategies that the Administering Authority may deploy in order to maintain employer contribution rates at as nearly a constant rate as possible. These include:-

- capping of employer contribution rate increases / decreases within a pre-determined range ("Stabilisation")
- the pooling of contributions amongst employers with similar characteristics
- the use of extended deficit recovery periods
- the phasing in of contribution increases / decreases

3.7.2 Stabilisation

There can be occasions when, despite the deployment of contribution smoothing mechanisms such as pooling, phasing and the extension of deficit recovery periods, the theoretical employer contribution rate is not affordable or achievable. This can occur in times of tight fiscal control or where budgets have been set in advance of new employer contribution rates being available.

The more secure the employer, the more emphasis can be placed on stability of employer contributions without jeopardising the Administering Authority's commitment to prudent stewardship of the Fund. For the most secure, long term employers an explicit stabilisation overlay based on a risk-based, stochastic valuation approach is used.

For less secure and shorter term employers (principally, but not exclusively, the admission bodies) it is generally not possible to achieve the same degree of stability in employer contribution rates without compromising on prudent stewardship.

In view of this possibility, the Administering Authority has commissioned the Fund Actuary to carry out extensive modelling to explore the long term effect on the Fund of capping future contribution increases. The results of this modelling indicate that it is justifiable to limit employer contribution rate changes to +0.25% / -2% of employers' contributions per annum for the six years from 1 April 2008, for employers where the Administering Authority is satisfied that the status of the employer merits adoption of a stabilised approach.

Circumstances in which eligibility for stabilisation will be reviewed

- The Administering Authority may review an employer's eligibility for stabilisation at any time in the event of significant changes in the employer's membership (due for example to redundancies or outsourcing) or if there is a significant change in the Administering Authority's assessment of an employer's security. Possible actions may include increases in contributions expressed as a percentage of pay or revised deficit contributions expressed as monetary amounts.

- Stabilisation rules and eligibility may be reviewed at any time in the event of changes to scheme benefits. Changes in scheme benefits may arise because of changes in regulations or other events that have a material impact (such as the change with effect from 22 June 2010 from RPI to CPI for increases to pensions in payment).

- The stabilisation rules and eligibility criteria will be reviewed no later than at the 31 March 2013 valuation, with any changes in contribution strategy taking effect from 1 April 2014. The review will take into account factors including, but not necessarily restricted to, market conditions (the long-term risk-based analysis will be recalibrated to market conditions as at 31 March 2013), the Administering Authority's assessment of employer's security and the maturity of each employer's membership profile.

Setting the parameters of the stabilisation overlay

The parameters for the stabilisation overlay have been determined by carrying out an asset liability modelling exercise. This allows for the future uncertainty in investment returns, interest rates and inflation using a stochastic modelling technique. The actuary tested the contribution stabilisation rules to ensure that they were compatible with the current investment strategy. The actuary has advised the Administering Authority that the stabilisation overlay for secure long term employers satisfies the requirement for the funding strategy to take a prudent longer-term view.

The actuarial modelling discloses that there is only around a 60% chance of the Fund having a funding level of at least 100% on an ongoing basis after 18 years, and this is slightly lower if stabilisation is applied. The actuary believes that there is a sufficiently high likelihood of achieving the long term funding objective (a funding level of 100% on a sufficiently prudent basis) where contributions are paid at the stabilised rate over a longer period.

In the interests of stability and affordability of employer contributions, the Administering Authority, on the advice of the Fund Actuary, believes that the results of the modelling demonstrate that stabilising contributions can still be viewed as a prudent longer-term approach. However, employers whose contribution rates have been “stabilised” and are therefore paying less than their theoretical contribution rate should be aware of the risks of this approach and should consider making additional payments to the Fund if possible.

The list of employers whose rates have been stabilised is set out in Annex A.

The Fund currently has a net cash inflow and can therefore take a medium to long term view on determining employer contribution rates to meet future liabilities through operating a fund with an investment strategy that reflects this long term view. It allows short term investment markets volatility to be managed so as not to cause volatility in employer contribution rates. However, this net cash inflow is reducing over time and so should be kept under review.

The LGPS regulations require the longer term funding objectives to be to achieve and maintain assets to meet the projected accrued liabilities. The role of the Fund Actuary in performing the necessary calculations and determining the key assumptions used, is an important feature in determining the funding requirements. The approach to the actuarial valuation and key assumptions used at each triennial valuation forms part of the consultation undertaken with the FSS.

3.7.3 Deficit Recovery Periods

The Administering Authority instructs the Actuary to adopt specific deficit recovery periods for all employers when calculating their contributions.

The Administering Authority normally targets the recovery of any deficit over a period not exceeding 20 years. However, these are subject to the maximum lengths set out in the table below.

Type of Employer	***Maximum* Length of Deficit Recovery Period**
Statutory bodies with tax raising powers	A period to be agreed with each employer not exceeding 20 years.
Community Admission Bodies with funding guarantees	A period to be agreed with each employer not exceeding 20 years.
Transferee Admission Bodies	The period from the start of the revised contributions to the end of the employer's contract or the date when it is expected that all employee members will have left active membership of the Fund, if earlier.
Academies	A period to be agreed with each employer not exceeding 20 years. Any recovery period in excess of 7 years will only be applicable for as long as the academy or Department of Education does not give notice of exiting its status. On receiving 7 years notice of exiting academy status, the outstanding deficit be spread over the remainder of the notice period.
Community Admission Bodies that are closed to new entrants e.g. Bus Companies, whose admission agreements continue after last active member retires	A period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers
All other types of employer	A period equivalent to the expected future working lifetime of the remaining scheme members

This maximum period is used in calculating each employer's minimum contributions. Employers may opt to pay higher regular contributions than these minimum rates.

The deficit recovery period starts at the commencement of the revised contribution rate (1 April 2011 for the 2010 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative spreading periods, for example to improve the stability of contributions.

3.7.4 Surplus Spreading Periods

Any employers deemed to be in surplus may be permitted to reduce their contributions below the cost of accruing benefits, by spreading the surplus element over the maximum periods shown above for deficits in calculating their minimum contributions.

However, to help meet the stability requirement, employers may prefer not to take such reductions.

3.7.5 Phasing in of Contribution Rises

Any contribution rate rises will be subject to the 'stabilisation mechanism' set out in Section 3.7.2. Transferee Admission Bodies are not eligible for phasing in of contribution rises. Other employers may opt to phase in contribution rises by phasing in the rise in contributions over a period of up to seven years.

3.7.6 Phasing in of Contribution Reductions

Any contribution reductions will be subject to the 'stabilisation mechanism' set out in Section 3.7.2. Transferee Admission Bodies can take the reduction with immediate effect.

3.7.7 The Effect of Opting for Longer Spreading or Phasing-In

Employers which are permitted and elect to use a longer deficit spreading period than other employers or to phase-in contribution changes will be assumed to incur a greater loss of investment returns on the deficit by opting to defer repayment. Thus, deferring paying contributions will lead to higher contributions in the long-term.

However any adjustment is expressed for different employers the overriding principle is that the discounted value of the contribution adjustment adopted for each employer will be equivalent to the employer's deficit.

3.7.8 Smaller Employers

The Administering Authority allows smaller employers of similar types to pool their contributions as a way of sharing experience and smoothing out the effects of costly but relatively rare events such as ill-health retirements or deaths in service.

Transferee Admission Bodies are ineligible for pooling.

Smaller employers may choose to Pool funds in future – As stated above. Transferee Admission Bodies, are not eligible for pooling.

Employers who are eligible for pooling at the 2010 valuation have consented to participate in the pool.

3.8 Admission Bodies ceasing

Admission Agreements for Transferee Admission Bodies are assumed to expire at the end of the contract.

Admission Agreements for other employers are generally assumed to be open-ended and to continue until the last pensioner dies. Contributions, expressed as capital payments, can continue to be levied after all the employees have retired. These Admission Agreements can however be terminated at any point.

If an Admission Body's admission agreement is terminated, the Administering Authority instructs the Fund Actuary to carry out a special valuation under Regulation 38 of the Administration Regulations to determine whether there is any deficit.

The assumptions adopted to value the departing employer's liabilities for this valuation will depend upon the circumstances. For example:

(a) For Transferee Admission Bodies, the assumptions would usually be those used for an ongoing valuation to be consistent with those used to calculate the initial transfer of assets to accompany the active member liabilities transferred.

(b) For non Transferee Admission Bodies that elect to voluntarily terminate their participation, the Administering Authority must look to protect the interests of other ongoing employers and will require the Actuary to adopt valuation assumptions which, to the extent reasonably practicable, protect the other employers from the likelihood of any material loss emerging in future. This could give rise to significant payments being required.

(c) For Admission Bodies with guarantors, it is possible that any deficit could be transferred to the guarantor in which case it may be possible to simply transfer the former Admission Bodies members and assets to the guarantor, without needing to crystallise any deficit.

Under (a) and (b), any shortfall would be levied on the departing Admission Body as a capital payment.

3.9 Early Retirement Costs

3.9.1 Non Ill Health retirements

The Actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health. All employers, irrespective of whether or not they are pooled, incur additional costs whenever an employee retires "early" (see below) with no reduction to their benefit or receives an enhanced pension on retirement. The current costs of these are specified in the latest early retirement manual from Hymans Robertson. Annex A indicates which employers pay additional lump sums into the Fund.

The additional costs of premature retirement are calculated by reference to these ages.

3.9.2 Ill health monitoring

The number of ill health retirements is carefully monitored against the assumptions included in the valuation.

4. Links to Investment Strategy

Funding and investment strategy are inextricably linked. Investment strategy is set by the Administering Authority, after consultation with the employers and after taking investment advice.

4.1 Investment Strategy

The investment strategy currently being pursued is described in the Fund's Statement of Investment Principles.

The investment strategy is set for the long-term, but is reviewed from time to time, normally every three years, to ensure that it remains appropriate to the Fund's liability profile. The Administering Authority has adopted a benchmark, which sets the proportion of assets to be invested in key asset classes such as equities, bonds and property. As at 31 March 2010, the proportion held in equities and property was 86% of the total Fund assets.

The investment strategy of lowest risk would be one which provides cashflows which replicate the expected benefit cashflows (i.e. the liabilities). Equity investment would not be consistent with this.

The lowest risk strategy is not necessarily likely to be the most cost-effective strategy in the long-term.

The Fund's benchmark includes a significant holding in equities in the pursuit of long-term higher returns than from a liability matching strategy. The Administering Authority's strategy recognises the relatively immature liabilities of the Fund, the security of members' benefits and the secure nature of most employers' covenants.

The same investment strategy is followed for all employers. The Administering Authority does not have the facility to operate different investment strategies for different employers.

4.2 Consistency with Funding Basis

The funding basis adopts an asset outperformance assumption of 1.6% per annum over and above the redemption yield on index-linked gilts. Both the Fund's Actuary and its investment adviser consider that the funding basis does conform to the requirement to take a "prudent longer-term" approach to funding, based on the Fund's current investment strategy.

The Administering Authority is aware that in the short term – such as the three yearly assessments at formal valuations – the proportion of the Fund invested in equities brings the possibility of considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of the outperformance target. The stability measures described in Section 3 will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.3 Balance between risk and reward

Prior to implementing its current investment strategy, the Administering Authority considered the balance between risk and reward by altering the level of investment in potentially higher yielding, but more volatile, asset classes like equities. This process was informed by the use of Asset-Liability techniques to model the range of potential future solvency levels and contribution rates.

4.4 Intervaluation Monitoring of Funding Position

The Fund is subject to an actuarial valuation every 3 years, which reviews assets and liabilities and assesses the funding level. Between these valuations the Administering Authority monitors investment performance on a quarterly basis. It reports back to employers by annual reports.

5. Key Risks & Controls

5.1 Types of Risk

The Administering Authority has an active risk management programme in place. The measures that the Administering Authority has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

5.2 Financial Risks

Risk	**Summary of Control Mechanisms**
Fund assets fail to deliver returns in line with the anticipated returns underpinning valuation of liabilities over the long-term	Only anticipate long-term return on a relatively prudent basis to reduce risk of under-performing.Short term (quarterly) investment monitoring analyses market performance. This gives an early warning of contribution rises ahead. In the short term, volatility is damped down by stability measures on contributions. However, if underperformance is sustained over a period, contributions would rise by more. Analyse progress at three yearly valuations for all employers.
Inappropriate long-term investment strategy	Set Fund-specific benchmark, informed by Asset-Liability modelling of liabilities.
Fall in risk-free returns on Government bonds, leading to a rise in value placed on liabilities	Some investment in bonds helps to mitigate this risk.
Active investment manager under-performance relative to benchmark	Short term (quarterly) investment monitoring analyses market performance and active managers relative to their index benchmark.
Actual pay and price inflation significantly more than anticipated	The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases. Some investment in index-linked bonds also helps to mitigate this risk. Employers pay for their own salary awards and are reminded of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.
Effect of possible increase in employer's contribution rate on service delivery and	Seek feedback from employers on scope to absorb short-term contribution rises.

Risk	**Summary of Control Mechanisms**
admission/scheduled bodies	Mitigate impact through deficit spreading and phasing in of contribution rises. Incorporate a stabilisation mechanism for employers where appropriate.

5.3 Demographic Risks

Risk	**Summary of Control Mechanisms**
Ill health retirements significantly more than anticipated	Monitoring of each employer's ill health experience on an ongoing basis. The employer may be charged additional contributions if this exceeds the ill health assumption built in.
Pensioners living longer	Set mortality assumptions with some allowance for future increases in life expectancy. Sensitivity analysis in triennial valuation calculations helps employers understand the potential impact of life expectancy. Fund Actuary monitors combined experience of around 50 LGPS funds to look for early warnings of lower pension amounts ceasing than assumed in funding. Administering Authority encourages any employers concerned at costs to promote later retirement culture. Each 1 year rise in the average age at retirement would save roughly 5% of pension costs.
Deteriorating patterns of early retirements	Employers are allocated the extra capital cost of non ill health retirements following each individual decision and may be required to make a capital payment. Employer ill health retirement experience is monitored.

5.4 Regulatory

Risk	Summary of Control Mechanisms
Changes to LGPS regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees or effect of tiered contribution rates with effect from 1 April 2008	The Administering Authority is alert to the potential creation of additional liabilities and administrative difficulties for employers and itself. It considers all consultation papers issued by the DCLG and comments where appropriate. The results of the Hutton review are not expected to affect the Fund until after the 2013 valuation, and so will be incorporated at that time. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions. The Administering Authority will consult employers where it considers that it is appropriate.
Changes to national pension requirements and/or HM Revenue & Customs rules	

5.5 Governance

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements).	The Administering Authority monitors membership movements on a quarterly basis. The Actuary may be instructed to consider revising the Rates and Adjustments certificate to increase an employer's contributions (under Regulation 38 of the Administration Regulations) between triennial valuations
Administering Authority not advised of an employer closing to new entrants.	
Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body and losing the opportunity to call in a debt.	In addition to the Administering Authority monitoring membership movements on a quarterly basis, it requires employers with Transferee Admission contracts to inform it of forthcoming changes. It also operates a diary system to alert it to the forthcoming termination of Transferee Admission Agreements.
An employer ceasing to exist with insufficient funding or adequacy of a bond.	The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure. The risk is mitigated by: • Seeking a funding guarantee from another scheme employer, or external body, wherever possible. • Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice. • Vetting prospective employers before admission. • Where permitted and appropriate under the regulations requiring a

Risk	Summary of Control Mechanisms
	bond to protect the scheme from the extra cost of early retirements on redundancy if the employer failed.

Annex A: Employers' Contributions, Spreading and Phasing Periods

The Common Rate of Contribution payable by each employing authority under regulation 36(4)(a) of the Administration Regulations for the period 1 April 2011 to 31 March 2014 is 25.7% of pensionable pay (as defined in Appendix B).

Individual Adjustments are required under regulation 36(4)(b) of the Administration Regulations for the period 1 April 2011 to 31 March 2014 resulting in Minimum Total Contribution Rates expressed as a percentage of pensionable pay are as set out below:

Employer code	Employer name	Contributions currently being paid in 2010/11	Minimum Contributions for the Year Ending		
			31 March 2012	31 March 2013	31 March 2014
1	London Borough of Harrow	18.6%	18.85%	19.10%	19.35%
2	North London Collegiate School	18.6%	18.85%	19.10%	19.35%
5	Stanmore College	18.6%	18.85%	19.10%	19.35%
7	Harrow College	18.6%	18.85%	19.10%	19.35%
8	Employer 8	18.6%	18.85%	19.10%	19.35%
10	Harrisons Catering	21.6%	22.50% *	22.50% *	22.50% *
11	St Dominic's Sixth Form College	18.6%	18.85%	19.10%	19.35%
16	Vaughan F&M School	18.6%	18.85%	19.10%	19.35%
18	Kier Support Services	18.1%	19.90% *	19.90% *	19.90% *
19	Mears Care Ltd	20.0%	20.00% *	20.00% *	20.00% *
20	Care UK	19.5%	22.30% *	22.30% *	22.30% *

* Early retirement strain payments are in addition

Further comments

Ill health liability insurance

Note that, if an employer has ill health liability insurance in place with a suitable insurer and provides satisfactory evidence to the administering authority, then their Minimum Total Contribution Rate may be reduced by their insurance premium, for the period the insurance is in place.

Stabilisation

The following employers have had their contribution rates stabilised following a separate modelling exercise that I [the Actuary] carried out on their behalf:

- London Borough of Harrow
- North London Collegiate School
- Stanmore College
- Harrow College
- Employer 8
- St. Dominic's Sixth Form College

- Vaughan F&M School

Annex B: Responsibilities of Key Parties

The Administering Authority should:

- collect employer and employee contributions;
- invest surplus monies in accordance with the regulations;
- ensure that cash is available to meet liabilities as and when they fall due;
- manage the valuation process in consultation with the Fund's Actuary;
- prepare and maintain a FSS and a SIP, both after proper consultation with interested parties; and
- monitor all aspects of the Fund's performance and funding and amend FSS/SIP.

The Individual Employer should:

- deduct contributions from employees' pay correctly;
- pay all contributions, including their own as determined by the Actuary, promptly by the due date;
- exercise discretions within the regulatory framework;
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; excess ill health early retirements if appropriate;
- notify the administering authorities promptly of all changes to membership or, as may be proposed, which affect future funding; and
- comply with the valuation timetable where required and respond to communications as necessary to complete the process.

The Fund Actuary should:

- prepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS;
- agree a timetable for the valuation process with the Administering Authority to provide timely advice and results; and
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters.